CONSOLIDATED FINANCIAL STATEMENTS

Valitás Health Services, Inc. and Subsidiaries
Years Ended December 31, 2011 and 2010
With Report of Independent Auditors

Ernst & Young LLP

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Consolidated Financial Statements

Years Ended December 31, 2011 and 2010

Contents

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Report of Independent Auditors

The Board of Directors
Valitás Health Services, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Valitás Health Services, Inc. and subsidiaries (collectively, the Company) as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholder's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Valitás Health Services, Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As disclosed in Note 2 to the consolidated financial statements, the Company changed its presentation of insurance claims and related insurance recoveries as a result of the adoption of the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2010-24, "Presentation of Insurance Claims and Related Insurance Recoveries."

Ernst + Young LLP

February 29, 2012

Valitás Health Services, Inc. and Subsidiaries

Consolidated Balance Sheets
(In Thousands)

	December 31	
	2011	**2010**
Assets		
Current assets:		
Cash and cash equivalents	**$ 10,051**	$ 33,158
Accounts receivable: healthcare and other, less allowances of	**114,267**	51,099
Inventories	**8,368**	6,760
Prepaid expenses and other current assets	**31,456**	3,701
Current deferred tax assets	**11,347**	4,907
Total current assets	**175,489**	99,625
Property and equipment, net	**23,142**	14,145
Goodwill	**442,600**	271,917
Customer contracts and relationships, net	**133,754**	58,295
Other intangibles, net	**25,376**	29,748
Other assets, net	**76,725**	14,913
Total assets	**$ 877,086**	$ 488,643
Liabilities and shareholder's equity		
Current liabilities:		
Current maturities of long-term debt and other note payable	**$ 2,850**	$ 9,256
Accounts payable	**18,578**	18,550
Accrued medical claims liability	**42,223**	22,511
Accrued expenses	**92,371**	32,557
Deferred revenue	**9,541**	1,225
Total current liabilities	**165,563**	84,099
Noncurrent portion of accrued expenses	**112,158**	26,607
Noncurrent deferred tax liabilities	**43,251**	26,889
Long-term debt, less current maturities	**381,907**	166,825
Total liabilities	**702,879**	304,420
Shareholder's equity:		
Common stock, par value $0.001 per share; 1,000 shares authorized, issued, and outstanding at December 31, 2011 and 2010	**–**	–
Paid-in capital	**168,958**	163,860
Accumulated other comprehensive loss	**(590)**	(1,396)
Retained earnings	**5,839**	21,759
Total shareholder's equity	**174,207**	184,223
Total liabilities and shareholder's equity	**$ 877,086**	$ 488,643

See accompanying notes.

Valitás Health Services, Inc. and Subsidiaries

Consolidated Statements of Operations
(In Thousands)

	Year Ended December 31 2011	2010
Health care revenues	**$ 1,063,369**	$ 749,533
Operating costs and expenses:		
Health care expenses	**938,819**	663,655
Selling, general, and administrative expenses	**49,977**	33,822
Depreciation and amortization	**37,196**	21,131
Merger expenses	**17,126**	–
Customer contracts and other intangible impairment	**–**	250
	1,043,118	718,858
Operating income	**20,251**	30,675
Interest expense, net	**(31,971)**	(18,067)
Income (loss) before income taxes	**(11,720)**	12,608
Income tax provision (benefit)	**(1,492)**	4,478
Net income (loss)	**$ (10,228)**	$ 8,130

See accompanying notes.

Valitás Health Services, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholder's Equity

(In Thousands)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholder's Equity
Balance, December 31, 2009	$ –	$ 162,008	$ 13,673	$ (1,931)	$ 173,750
Net income	–	–	8,130	–	8,130
Change in fair value of cash flow hedges, net of tax effect of $350	–	–	–	535	535
Total comprehensive income	–				8,665
Contribution from parent	–	1,000	–	–	1,000
Dividends paid to LLC	–	–	(44)	–	(44)
Unit compensation	–	852	–	–	852
Balance, December 31, 2010	–	163,860	21,759	(1,396)	184,223
Net loss			**(10,228)**	**–**	**(10,228)**
Other comprehensive income amortization net of tax effect of $403	–	–	–	**806**	**806**
Total comprehensive loss	–				**(9,422)**
Contribution from parent	–	**3,446**	–	–	**3,446**
Dividends paid to LLC	–	–	**(5,692)**	–	**(5,692)**
Unit compensation	–	**1,652**	–	–	**1,652**
Balance, December 31, 2011	$ –	$ **168,958**	$ **5,839**	$ **(590)**	$ **174,207**

See accompanying notes.

Valitás Health Services, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended December 31	
	2011	**2010**
Operating activities		
Net income (loss)	**$ (10,228)**	$ 8,130
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	**37,196**	21,131
Customer contracts and other intangible impairment	–	250
Finance cost amortization	**2,533**	1,792
Write off of prior debt issuance costs	**4,938**	–
Deferred income taxes	**(15,304)**	(3,246)
Unit compensation	**1,652**	852
Paid-in-kind interest	**1,182**	909
Changes in operating assets and liabilities:		
Receivables	**(12,228)**	(9,138)
Inventories and other current assets	**(13,815)**	1,304
Accounts payable and accrued expenses	**42,607**	(5,543)
Other operating activities	**(41,683)**	2,919
Net cash provided by (used in) operating activities	**(3,150)**	19,360
Investing activities		
Capital expenditures	**(6,296)**	(5,751)
Purchase of America Service Group Inc., net of cash acquired	**(200,991)**	–
Net cash (used in) investing activities	**(207,287)**	(5,751)
Financing activities		
Proceeds from long-term debt	**385,000**	–
Repayments of long-term debt	**(177,507)**	(21,108)
Debt issuance costs	**(17,917)**	–
Shareholder contribution	**3,446**	1,000
Dividends paid	**(5,692)**	(44)
Net cash provided by (used in) financing activities	**187,330**	(20,152)
Decrease in cash and cash equivalents	**(23,107)**	(6,543)
Cash and cash equivalents, beginning of period	**33,158**	39,701
Cash and cash equivalents, end of period	**$ 10,051**	$ 33,158
Supplemental disclosure of non-cash financing activities		
Interest expense deferred to principal balance	**$ 1,182**	$ 909

See accompanying notes.

Valitás Health Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2011

1. Nature of Business

Description of Business

Valitás Health Services, Inc. (the Company) is a holding company for the consolidated operations of America Service Group Inc. (ASG), Correctional Medical Services of Delaware, Inc. (CMSD) and Valitás Behavioral Services of Delaware, Inc. (VBSD), together with their wholly owned subsidiaries. The Company, through its operating subsidiaries, primarily provides contract healthcare services to correctional facilities owned or operated by state and local governments geographically dispersed across the United States.

The Company is wholly owned by Valitás Equity LLC, a Delaware limited liability company (LLC) through LLC's wholly owned subsidiary Valitás, Inc., a Delaware corporation. LLC and Valitás, Inc. have no other operations other than their investment in the Company.

As discussed more fully in Note 3, on June 3, 2011, the Company acquired ASG in a transaction accounted for as a purchase (the Acquisition). The consolidated financial statements include the results of operations of ASG from June 3, 2011 to December 31, 2011.

Subsequent to the Acquisition, the Company changed the name of the primary operating subsidiary of CMSD from Correctional Medical Services, Inc. to Corizon, Inc. and the name of the primary operating subsidiary of ASG from Prison Health Services, Inc. to Corizon Health, Inc.

2. Significant Accounting Policies

Basis of Presentation

All majority-owned subsidiaries of the Company are consolidated, and all intercompany accounts and transactions are eliminated.

The Company evaluated subsequent events through March 2, 2012, the date these consolidated financial statements were issued. No material subsequent events have occurred since December 31, 2011, that required recognition or disclosure.

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to, the accrual estimates for medical claims payable, professional liability claims reserves, income tax reserves and valuation allowances, allowance for doubtful accounts, and workers' compensation claims reserves. The accounting estimates used in the preparation of the consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as the operating environment changes. The Company evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in the evaluation, as considered necessary. Actual results could differ from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits and money market funds which can be liquidated within three months or less when purchased. Due to the short term nature of these instruments, the carrying amounts approximate fair value.

Derivative Instruments

The Company periodically enters into interest rate swap agreements to effectively convert a portion of the interest on its floating rate debt to a fixed rate, thus reducing the impact of interest rate changes on future interest expense. The Company does not hold or issue derivative financial instruments for speculative purposes. The Company recognizes all of its derivative instruments as either assets or liabilities on the consolidated balance sheets at fair value. Changes in the fair value of these instruments are reported in earnings or other comprehensive income depending on the use of the derivative and whether it qualifies for hedge accounting. The accounting for gains and losses associated with changes in the fair value of the derivative and the effect on the consolidated financial statements depends on its hedge designation and whether the hedge is highly effective in achieving offsetting changes in the fair value of cash flows of the liability hedged.

2. Significant Accounting Policies (continued)

Revenue and Cost Recognition

The Company engages principally in contracts with correctional institutions whereby the Company receives a contracted fee, typically based on the inmate population covered, and administers for the state or governmental agency the delivery of healthcare to the covered population. The Company records revenues net of estimated allowances resulting from failure to meet contractual requirements. Many contracts also include additional provisions such as aggregate pools, specific exclusions, or cost plus fee arrangements that mitigate a portion of off-site medical and pharmaceutical costs charged to the Company. For contracts that include such provisions, the Company recognizes revenues that would be due from or to clients based upon estimates of costs incurred compared to the corresponding contractual limit for such costs. Revenues earned are recognized in the period that services are rendered. Certain contracts allow the Company to bill in advance for services, and accordingly, such revenue is deferred and recognized when services are rendered.

Healthcare expenses include the compensation of nurses and other employed healthcare professionals (including any related benefits), physician compensation, benefits and independent contractor fees, hospitalization, other subcontractor and vendor costs, and other direct costs of providing care. The healthcare expenses are recognized in the period in which they are provided based in part on estimates, including an accrual for unbilled medical services rendered through the balance sheet date. The Company estimates the accrual for unbilled medical services using paid claim and utilization data including hospitalization, one-day surgeries, physician visits and emergency room and ambulance visits and their corresponding costs. An actuarial analysis is prepared at least annually as an additional tool to be considered by management in evaluating the adequacy of the Company's total accrual related to contracts which have sufficient claims payment history. The analysis takes into account historical claims experience (including the average historical costs and billing lag time for such services) and other actuarial data.

Actual payments and future accrual requirements will differ from the Company's current estimates. The differences could be material if significant fluctuations occur in the healthcare cost structure or the Company's claims experience. The development of the medical claims payable estimate is a continuous process monitored and refined on a monthly basis as additional claims information becomes available. The reserving methodology is consistently applied from period to period. Changes in estimates of claims resulting from such fluctuations and differences between estimates and actual claims payments are recognized in the period in which the estimates are changed or the payments are made. In 2011 and 2010, the Company recorded an

2. Significant Accounting Policies (continued)

increase of approximately \$1.3 million and a decrease of approximately \$2.1 million, respectively, to its prior year claims liabilities as a result of revisions to its estimated claims expense. The impact to net income of these reductions to the Company's claims reserves and associated expense is dependent upon whether any of the associated customer contracts contained provisions limiting risk.

Accounts Receivable

Accounts receivable represent amounts due from state and local governments for healthcare services provided and/or administered by the Company. Included in unbilled accounts receivable is the Company's estimate of revenue earned under risk sharing provisions.

Accounts receivable are stated at estimated net realizable value. The Company recognizes allowances for doubtful accounts based on a variety of factors, including the length of time receivables are past due, significant one-time events, contractual rights, client funding and/or political pressures, discussions with clients and historical experience. If circumstances change, estimates of the recoverability of receivables would be further adjusted and such adjustments could have a material adverse effect on the Company's results of operations in the period in which they are recorded.

Inventories

Pharmacy and medical supplies inventories are stated at the lower of cost (first-in, first-out method) or market.

Income Taxes

Deferred tax assets and liabilities are recorded for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date of the tax rate change.

2. Significant Accounting Policies (continued)

Valuation allowances are provided when it is considered more likely than not that deferred tax assets will not be realized. In determining if a deductible temporary difference or net operating loss can be realized, the Company considers future reversals of existing taxable temporary differences, future taxable income, taxable income in prior carryback periods, and tax planning strategies.

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives for the major categories of property and equipment are ten to thirty years for buildings and improvements and three to eight years for furniture, computer hardware and software, equipment and fixtures. Leasehold improvements are amortized over the useful life or the remaining term of the lease, whichever is shorter. Expenditures for maintenance and repairs are charged to expense as incurred, whereas expenditures for improvements and replacements are capitalized. The cost and accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts and the resulting gain or loss is reflected in the consolidated statements of operations.

Software Costs

The Company capitalizes costs associated with internally developed software systems that have reached the application development stage. Capitalized costs include external direct costs of materials and services utilized in developing or obtaining internal-use software and payroll and payroll-related expenses for employees who are directly associated with and devote time to the internal-use software project. Capitalization of such costs begins when the preliminary project stage is complete and ceases no later than the point at which the project is substantially complete and ready for its intended purpose. In addition, the Company capitalizes costs associated with upgrades or enhancements to its internally developed software systems which result in additional functionality.

2. Significant Accounting Policies (continued)

Goodwill, Contracts, and Other Intangible Assets

The Company accounts for goodwill, customer contracts, and other intangible assets in accordance with ASC 350. Intangible assets were estimated by an independent valuation specialist based on the fair value. Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination and is not subject to amortization. ASC 350 requires that goodwill be tested for impairment at least annually, or more often if warranted by events and changes in circumstances indicating that the carrying value may exceed its fair value, and written down to fair value if impaired. Absent any impairment indicators, the Company performs its goodwill impairment testing during the fourth quarter of each year.

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-08, an update to FASB ASC Intangibles—Goodwill and Other Topic, which amends the existing accounting standards related to the method of assessing goodwill for potential impairment. Specifically, this update limits the requirement for a company to perform a quantitative goodwill impairment test to situations in which management believes it is more likely than not that the fair value of a reporting unit is less than its carrying amount. This update becomes effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company adopted this update effective with its December 31, 2011 annual goodwill impairment test. Such adoption did not have a material impact on the consolidated financial statements.

Based on an assessment of qualitative factors, the Company determined that it is more likely than not that the carrying amount of the Company's reporting unit exceeds its fair value. As a result, the Company concluded that no further testing for goodwill impairment was required.

ASC 350 also requires that intangible assets with finite useful lives be amortized over their respective estimated useful lives and tested for impairment if certain circumstances indicate a possible impairment may exist. Customer contracts and relationships are amortized based on the pattern of economic benefit received from the contract, which is currently estimated over one to 16 years. The Company's other intangible assets consist of trade names and non-compete agreements (see Note 9). Non-compete agreements were amortized on a straight-line basis over their useful lives of four years and were fully amortized as of December 31, 2011.

2. Significant Accounting Policies (continued)

Prior to 2011, the Company's intangible assets related to trade names had an indefinite life and were not amortized. As a result of the rebranding and name changes for the primary operating subsidiaries discussed in Note 1 above, the Company concluded that the intangible assets associated with its existing trade names have a limited life. Beginning June 3, 2011, these assets will be amortized over a 2 year life.

Deferred Financing Costs

Expenses associated with the issuance of debt instruments are capitalized and amortized over the terms of the respective financing arrangement using a method similar to the effective interest method over periods ranging from five to seven years.

Unit Based Compensation

Certain directors, officers, and employees of the Company participate in the LLC's equity incentive plan. Compensation cost includes compensation cost for all share-based payments granted under the plans, based on the grant-date fair value. The Company recognizes the cost as expense on a straight-line basis (net of estimated forfeitures) over the requisite service period. The Company estimates the fair value of the incentive units using the Black-Scholes option-pricing model. The expense is recorded in selling, general, and administrative expenses in the consolidated statements of operations.

Recent Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-24 "Presentation of Insurance Claims and Related Insurance Recoveries," which provides clarification to companies in the healthcare industry on the accounting for professional liability insurance. This ASU states that receivables related to insurance recoveries should not be netted against the related claim liability and such claim liabilities should be determined without considering insurance recoveries. This ASU is effective for fiscal years beginning after December 15, 2010 and was adopted by the Company on January 1, 2011. The adoption of this ASU increased prepaid expenses and other current assets by $15.6 million, other assets, net by $42.9 million, accrued expenses by $15.6 million and non-current portion of accrued expenses by $42.9 million in the consolidated balance sheet at December 31, 2011 and had no impact to the consolidated statement of operations for year ended December 31, 2011.

2. Significant Accounting Policies (continued)

The Company has determined that all other recently issued accounting pronouncements will not have a material impact on its consolidated financial position, results of operations, and cash flows or do not apply to its operations.

Reclassifications

Certain prior period amounts have been reclassified in order to conform to current period presentation.

3. Acquisition

On June 3, 2011, the Company acquired all of the voting shares of ASG. ASG is a provider of contract healthcare services to correctional facilities owned or operated by state and local governments geographically dispersed across the United States. The Company paid $201.0 million in cash at closing, net of $48.5 million of cash acquired in the Acquisition. The cash purchase price was funded through the issuance of the new debt facility discussed in Note 13. The results of operations of ASG are included in the consolidated financial statements of the Company for all periods subsequent to June 3, 2011.

Under the acquisition method of accounting, the purchase price, net of cash, totaling $201.0 million was allocated to the identifiable assets acquired and liabilities assumed based upon their estimated fair values as of June 3, 2011. The excess of the purchase price over the estimated fair value of the identifiable assets acquired and liabilities assumed was recorded as goodwill. Goodwill recorded for this transaction represents the business value of the entity not specifically related to net assets acquired. The goodwill of $169.5 million is not expected to be deductible for tax purposes.

Valitás Health Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Acquisition (continued)

The Company's preliminary estimate of the fair value of assets acquired and liabilities assumed in the transaction is as follows:

		2011
Accounts receivable, net of allowances of $0.5 million	$	50,939
Other current assets		15,550
Property, software and equipment		11,198
Other assets		11,639
Identified intangibles		99,800
Goodwill		169,530
Total assets acquired		358,656
Current liabilities		(102,192)
Long term liabilities		(31,905)
Deferred tax liabilities		(23,568)
Total liabilities assumed		(157,665)
Net assets acquired	$	200,991

Acquisition related expenses totaling $17.1 million were incurred during 2011 in connection with the transaction are included in the accompanying consolidated statements of operations as merger expenses.

4. Major Customers and Geographical Concentrations

The Company contracts with several state-wide prison systems, which potentially expose the Company to concentrations of credit risk. Contracts with the states of Alabama, Indiana and Missouri constituted approximately 27.8% of revenues for the year ended December 31, 2011, and 8.5% of total receivables at December 31, 2011. Contracts with the states of Alabama, Indiana and Missouri constituted approximately 38% of revenues for the year ended December 31, 2010, and 19.3% of total receivables at December 31, 2010.

In addition, as of December 31, 2011, the Company has approximately $19.8 million of unbilled receivables, 17.4% of total receivables, related to two existing customers whose contract renewals are in the final stages of execution. The Company expects these contracts to be executed in early 2012, at which point these receivables will be billed and collection can occur.

During 2011 and 2010, some of the Company's contracts expired in the normal course of business. The table below presents the operating results, net of taxes, that are included in the accompanying statements of operations (in thousands):

	December 31	
	2011	**2010**
Healthcare revenues	**$ 34,884**	$ 44,220
Healthcare expenses	**32,418**	36,986
Income from expired contracts before taxes	**2,466**	7,234
Income tax provision	**1,011**	2,966
Income from expired contracts, net of taxes	**$ 1,455**	$ 4,268

5. Accounts Receivable

Accounts receivable consist of the following (in thousands):

	December 31 2011	December 31 2010
Billed accounts receivable	$ **51,720**	$ 12,428
Unbilled accounts receivable	**58,600**	29,746
Other accounts receivable	**6,830**	11,646
	117,150	53,820
Less: allowances	**(2,883)**	(2,721)
	$ **114,267**	$ 51,099

Unbilled accounts receivable generally represent additional revenue earned that remain unbilled at each balance sheet date, due to provisions within the contracts governing the timing for billing such amounts.

6. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets are stated at amortized cost and comprised of the following (in thousands):

	December 31 2011	December 31 2010
Prepaid insurance	$ **6,673**	$ 1,789
Insurance recoveries related to professional liability claims losses	**15,631**	–
Prepaid cash deposits for professional liability claims losses	**5,111**	–
Prepaid other	**4,041**	1,912
	$ **31,456**	$ 3,701

Valitás Health Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

7. Property and Equipment

Property and equipment are stated at cost and comprised of the following (in thousands):

	December 31 2011	December 31 2010
Computer hardware and software	**$ 37,517**	$ 22,703
Buildings and improvements	**1,753**	843
Furniture, equipment and fixtures	**3,480**	2,282
	42,750	25,828
Less: accumulated depreciation	**(19,608)**	(11,683)
	$ 23,142	$ 14,145

Depreciation expense, including amortization of capitalized software costs, for the years ended December 31, 2011 and 2010 was approximately $8.4 million and $5.3 million, respectively.

8. Other Assets

Other assets are stated at amortized cost and comprised of the following (in thousands):

	December 31 2011	December 31 2010
Deferred financing costs	**$ 18,229**	$ 11,084
Less: accumulated amortization	**(1,786)**	(5,400)
	16,443	5,684
Insurance recoveries related to professional liability claims losses	**42,911**	–
Prepaid cash deposits for professional liability claims losses	**5,613**	–
Prepaid insurance deposits and other	**4,744**	–
Supplemental retirement plan	**7,014**	9,229
	$ 76,725	$ 14,913

9. Customer Contracts, Relationships, and Other Intangible Assets

Due to the loss of certain customer contracts in 2010, the Company recorded impairment charges of $0.3 million to customer contracts. The Company recorded no impairment charges in 2011.

The gross and net values of contracts and other intangible assets consist of the following (in thousands):

	December 31 2011		December 31 2010	
Contracts:				
Gross value	**$**	**200,630**	$	107,330
Less: accumulated amortization		**(66,876)**		(49,035)
	$	**133,754**	$	58,295
Trade names:				
Gross value	**$**	**35,680**	$	29,180
Less: accumulated amortization		**(10,304)**		–
	$	**25,376**	$	29,180
Non-compete agreements:				
Gross value	**$**	**–**	$	2,304
Less: accumulated amortization		**–**		(1,736)
	$	**–**	$	568

Prior to the acquisition of ASG on June 3, 2011, as discussed in Note 3, the CMSD trade name had an indefinite life. However, due to the rebranding and name changes for the primary operating subsidiaries, the Company concluded that the intangible associated with the trade names have a limited life and will be amortized over two years.

9. Customer Contracts, Relationships, and Other Intangible Assets (continued)

Amortization expense, including impairment charge, for the years ended December 31, 2011 and 2010, was $28.8 million and $15.5 million, respectively. Estimated aggregate amortization expense related to the above intangibles for the five years subsequent to December 31, 2011 are approximately $37.6 million, $24.1 million, $13.6 million, $10.4 million and $9.0 million, respectively.

10. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	December 31	
	2011	**2010**
Salaries and employee benefits	**$ 36,356**	$ 15,843
Professional liability claims	**65,361**	13,423
Accrued workers' compensation claims	**10,796**	5,691
Professional liability claims losses recoverable through insurance	**58,542**	–
Other	**33,474**	24,207
	204,529	59,164
Less: noncurrent portion of professional liability claims losses recoverable through insurance	**(42,911)**	–
Less: noncurrent portion of professional liability and workers' compensation claims	**(59,627)**	(13,553)
Less: supplemental retirement plan liability	**(7,014)**	(9,229)
Less: other	**(2,606)**	(3,825)
	$ 92,371	$ 32,557

Valitás Health Services, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Income Taxes

The provision (benefit) for income taxes consists of (in thousands):

	December 31 2011	December 31 2010
Current:		
Federal	$ 11,892	$ 6,105
State and local	1,920	1,619
	$ 13,812	$ 7,724
Deferred:		
Federal	$ (13,527)	$ (2,872)
State and local	(1,777)	(374)
	$ (15,304)	$ (3,246)
Income tax expense (benefit)	$ (1,492)	$ 4,478

The federal statutory income tax rate is reconciled to the effective tax rate from continuing operations as follow:

	Year Ended December 31 2011	Year Ended December 31 2010
U.S. statutory income tax rate	(35.0)%	35.0%
State income taxes, net of federal tax benefit	(5.7)	5.1
Permanent book/tax differences	9.0	4.0
Costs associated with the Acquisition	10.3	–
Reserve for uncertain tax positions	0.7	(7.9)
Change in effective tax rate on deferred taxes	5.7	–
Other	2.3	(0.7)
Effective income tax rate	(12.7)%	35.5%

In 2010, the Company closed its federal audit of tax years 2005 through December 26, 2007, analyzed its income tax positions based upon the audit findings, and recorded a $0.6 million decrease, net of additional state items, in its reserve for uncertain tax positions.

11. Income Taxes (continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets (liabilities) are as follows (in thousands):

	December 31 2011	December 31 2010
Deferred tax assets:		
Accruals and receivable allowances	**$ 2,875**	$ 669
Professional liability claims	**26,569**	5,308
Deferred compensation	**2,965**	3,750
Interest rate swaps	**–**	914
Workers' compensation	**4,389**	1,968
Other	**2,951**	644
Total deferred tax assets	**39,749**	13,253
Deferred tax liabilities:		
Intangibles	**(64,835)**	(32,890)
Property and equipment	**(6,818)**	(2,345)
Total deferred tax liabilities	**(71,653)**	(35,235)
Net deferred tax liability	**$ (31,904)**	$ (21,982)
Reported as:		
Current deferred tax assets	**$ 11,347**	$ 4,907
Noncurrent deferred tax liabilities	**(43,251)**	(26,889)
Net deferred taxes	**$ (31,904)**	$ (21,982)

Income taxes (received) paid were approximately $(0.2) million and $11.3 million during the years ended December 31, 2011 and 2010, respectively.

11. Income Taxes (continued)

A reconciliation of the beginning and ending balance of the liabilities for uncertain tax positions is as follows (in thousands):

Balance as of January 1, 2011	$	2,075
Gross increase – current year tax positions taken		276
Gross decrease – prior year tax positions taken		–
Lapse of statute of limitations		–
Balance as of December 31, 2011	$	2,351

The Company recognizes interest accrued related to unrecognized tax benefits in the provision for income taxes. Included in the reserve for uncertain tax positions is a liability for interest in the amount of $0.1 million. As of December 31, 2011, $2.3 million of the reserve for uncertain tax positions would, if recognized, affect the effective tax rate in future periods. The entire $2.4 million balance is included in noncurrent portion of accrued expenses in the consolidated balance sheets. The Company does not expect any significant increases or decreases to these liabilities within 12 months of this reporting date.

The federal income tax returns of the Company for the tax period beginning December 27, 2007 through tax year 2011 remain subject to examination. The Company files in numerous state jurisdictions with varying statutes of limitation. The state income tax returns for tax years 2005 through 2011 remain subject to examination. An audit of the federal tax returns of ASG for the year ended December 31, 2010 and the period ended June 2, 2011 is currently in progresss.

12. Professional Liability Insurance

The Company maintains professional liability (medical malpractice) insurance in amounts that it considers appropriate based upon the nature of its business, industry practice, and past claims experience. This coverage is for the Company and its employees. The Company's independently contracted physicians may participate in this coverage or obtain their own so long as it is comparable. The Company's professional liability program includes occurrence-based insurance, claims-made insurance, self-insured retention, and reinsurance obtained through third-party insurers.

12. Professional Liability Insurance (continued)

The Company estimates it liability for professional liability claims losses after taking into consideration the Company's professional liability claims department and external counsel evaluations of the merits of individual claims, analysis of claim history and analysis by outside actuaries. When appropriate, based on the coverage terms, the Company also records an estimate of incurred but reported claims based on an analysis of claims history and analysis by outside actuaries. Estimated liabilities are discounted using rates appropriate with the risks involved.

Prior to January 1, 2011 the Company recorded its liabilities for professional liability claims net of expected insurance recoveries. As discussed in Note 2, effective January 1, 2011 the Company adopted the guidance of ASU 2010-24 which requires such liabilities to be recorded gross of expected insurance recoveries. As a result, the liabilities recorded at December 31, 2011 include an additional $58.5 million in losses expected to be reimbursed through insurance policies. At December 31, 2011, an aggregate receivable of $58.5 million is recorded for the expected insurance recoveries. The current portion of this receivable is recorded in prepaid expenses and other current assets and the noncurrent portion of this receivable is recorded in other assets in the consolidated balance sheet.

The ultimate amount of such liabilities may differ from the Company's estimate of such liabilities, and any resulting change in estimate will be reflected in the period in which such change becomes apparent.

13. Long-Term Debt and Other Notes Payable

Long-term debt as of December 31, consists of the following (in thousands):

	December 31 2011	December 31 2010
2011 Term Loan B payable in quarterly installments of $0.7 million through June 3, 2017, interest at 5.75% at December 31, 2011	**$ 283,575**	$ –
2011 Senior Subordinated Notes due June 3, 2018, interest at 12.5% at December 31, 2011	**101,182**	–
2007 Term Loan A payable in quarterly installments through December 2013, repaid in June 2011, interest at 4.30% at December 31, 2010	–	99,006
2007 Term Loan B payable June 27, 2014, repaid in June 2011, interest at 6.81% at December 31, 2010	–	31,250
2007 Senior Subordinated Notes due December 27, 2014, repaid in June 2011 interest at 14.25% at December 31, 2010	–	45,439
Other	–	386
	384,757	176,081
Less current maturities	**2,850**	9,256
	$ 381,907	$ 166,825

Scheduled principal payments of long-term debt as of December 31, 2011, are as follows (in thousands):

2012	$ 2,850
2013	2,850
2014	2,850
2015	2,850
2016	2,850
Thereafter	370,507
Total	$ 384,757

13. Long-Term Debt and Other Notes Payable (continued)

In June 2011, in conjunction with and to finance the Acquisition, the Company refinanced its then existing credit facility with a new credit facility (Credit Agreement) with a syndicate of financial institutions consisting of a $285.0 million six-year term loan (2011 Term Loan B) and a $75.0 million five-year revolving line of credit (2011 Revolver). The Company's previous credit facility (2007 Credit Facility) consisted of a $141.0 million six-year term loan (2007 Term Loan A), a $31.3 million six-and-one-half-year term loan (2007 Term Loan B), and a $50.0 million six-year revolving line of credit (2007 Revolver). The 2011 Term Loan B is repayable in quarterly installments of $712,500 beginning September 2011 over six years with a balloon payment due in June 2017. Interest on the term loans under the Credit Agreement is at varying rates at the Company's option based either on LIBOR rates or the base rate as defined. A commitment fee ranging based on the net leverage ratio from 0.50% to 0.75%, per annum (0.75% at December 31, 2011) is charged on the unused portion of the 2011 Revolver. The Credit Agreement contains various covenants, which, among other things, require the maintenance of fixed charge coverage, maximum debt leverage ratios, and limitations on capital expenditures, investments, indebtedness, liens, sales of assets, and restricted payments. At December 31, 2011, the Company was in compliance with the covenants.

In addition, the Credit Agreement requires the Company to prepay the 2011 Term Loan B with up to 50% of its excess cash flow, as defined in the Credit Agreement, annually beginning for the year ending December 31, 2012. Obligations under the Credit Agreement are guaranteed by the principal subsidiaries of the Company and are secured by essentially all of the assets of the Company and its principal subsidiaries, as well as the stock of such subsidiaries.

Also, in conjunction with the Acquisition, the Company issued $100.0 million of 12.50% senior subordinated notes (2011 Subordinated Notes) under the terms of the Note Purchase Agreement (Note Purchase Agreement). The Company used the proceeds to repay senior subordinated notes issued in 2007 (2007 Subordinated Notes) and to fund the Acquisition. The 2011 Subordinated Notes are subordinated to the obligations under the Credit Agreement. The 2011 Subordinated Notes bear interest at 12.50% per annum, payable quarterly. The Company may defer the payment of 2.0% of the 12.50% coupon, with any such deferred amount added to principal and payable at maturity. As of December 31, 2011, the Company has deferred payments of $1.2 million of interest. Such amount has been added to the outstanding balance of the 2011 Subordinated Notes in the accompanying consolidated balance sheet. The 2011 Subordinated Notes are guaranteed by the principal subsidiaries of the Company and have a single maturity in June 2018. Covenants under the 2011 Subordinated Notes are similar to but generally less restrictive than those under the Amended and Restated Financing Agreement.

13. Long-Term Debt and Other Notes Payable (continued)

Net cash payments of interest for the years ended December 31, 2011 and 2010 were \$23.0 million and \$15.6 million, respectively.

14. Revolving Credit Facility

There were no borrowings under either the 2011 Revolver or the 2007 Revolver at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the Company had \$8.2 million and \$12.5 million of letters of credit outstanding, respectively. At December 31, 2011 and 2010, the Company had \$66.8 million and \$37.5 million of unused availability under the Revolver, respectively, net of letters of credit.

15. Interest Rate Swaps and Cap

To hedge variable rate borrowings under the Credit Agreement, in July 2011 the Company entered into an Interest Rate Cap Transaction Agreement in which the counterparty agreed to reimburse the Company to the extent the one-month LIBOR exceeds 3% on a notional amount of \$142.5 million. This agreement expires in July 2013. The Company paid \$0.1 million for this agreement, which is being amortized over its life.

To hedge variable rate borrowings under the 2007 Credit Facility, in January 2008, the Company entered into a \$25 million two-year, a \$25 million three-year, a \$25 million four-year, and a \$25 million five-year interest rate swap. These swaps effectively convert variable rate borrowings to fixed rate borrowings and were considered a highly effective cash flow hedge. At June 3, 2011, the \$25 million two-year interest rate swap and the \$25 million three-year interest rate swap had expired. At December 31, 2010, cumulative ineffectiveness of the hedge was considered immaterial, and no adjustment to interest expense was recorded.

As a result of the refinancing which occurred in June 2011, the Company was required to terminate the remaining two \$25 million swaps which had not expired. In conjunction with these terminations, the Company paid a total of \$2.2 million to the counterparties to the swaps. This amount is being amortized over the lives of the terminated swaps, including \$1.3 million which was amortized to interest expense in 2011. At December 31, 2011 and 2010, \$0.6 million and \$1.4 million, respectively, were included in other comprehensive income, net of deferred taxes. At December 31, 2010, \$0.8 million was included in other current liabilities and \$1.5 million was included in other long-term liabilities on the accompanying consolidated balance sheets.

16. Fair Value Measurements

Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the extent to which the fair value estimates are based upon observable or unobservable inputs. Level inputs are as follows:

Level Input	Input Definition
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs other than quoted prices included in Level I that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes fair value measurements by level at December 31, 2011, for assets and liabilities measured at fair value on a recurring basis (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 10,051	$ –	$ –	$ 10,051
Supplemental retirement plan investments – mutual funds	7,014	–	–	7,014

The following table summarizes fair value measurements by level at December 31, 2010, for assets and liabilities measured at fair value on a recurring basis (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 33,050	$ –	$ –	$ 33,050
Supplemental retirement plan investments – mutual funds	9,229	–	–	9,229
Liabilities				
Interest rate swaps	–	2,309	–	2,309

16. Fair Value Measurements (continued)

The fair values of supplemental retirement plan investments – mutual funds and money market mutual funds were determined based on quoted market prices of the funds. The fair values of interest rate swaps were determined based on the present value of expected future cash flows using current market data including interest rate curves and credit spreads. At December 31, 2011 and 2010, the book values of cash, trade and other accounts receivable, and accounts payable and long term debt approximate their fair values.

17. Preferred Units

At December 31, 2011 and 2010, the LLC had 200,000,000 preferred units authorized, of which 160,749,340 and 161,030,132, respectively, were issued and outstanding. The preferred units have a unit value of $1.00 per unit. Preferred yield accrues on each preferred unit up to a maximum rate of 10% per annum, compounded on the last day of each quarter. The accumulated liquidation values at December 31, 2011 and 2010, were $237.2 and $216.5 million, respectively. Distributions to unit holders, at the LLC's discretion, are paid out first to preferred unit holders in the amount equal to the aggregate amount of unpaid preferred yield and then to preferred unit holders in the amount of unreturned capital. Distributions to the preferred unit holders would be funded from the Company as it is the LLC's only operating subsidiary.

18. Capital Units

At December 31, 2011 and 2010, the LLC had 200,000,000 Class A common units authorized in which 160,749,340 and 160,459,520, respectively, were issued and outstanding. At December 31, 2011 and 2010, the LLC had 30,000,000 and 20,000,000, respectively, Class B common units authorized, of which 21,822,336 and 14,603,082, respectively, were issued and outstanding. Any distributions to Class A and Class B common unit holders would be paid out only after preferred unit holders have received a 10% per annum return on investment and full return on capital. Distributions to the common unit holders would be funded from the Company as it is the LLC's only operating subsidiary.

19. Unit Compensation Plans

Certain directors, officers, and employees of the Company participate in sponsored equity incentive plans of the LLC. Under these plans, certain directors, officers, and employees of the Company may be issued 30,000,000 Class B units of the LLC at amounts approximating fair value at the dates of issuance. Class B units generally vest monthly over three to four years from the dates of issuance.

19. Unit Compensation Plans (continued)

The Company uses the Black-Scholes option-pricing model to estimate the fair value of the Class B units on the date of grant. The expected volatilities are based on the historical volatilities of industry-comparable companies. The Company uses historical data to estimate option exercise and employee termination. The expected life is based on management's estimate of the holding period for the Class B units. The risk-free interest rates are based on the U.S. Treasury issues with a remaining term equal to the expected life. The assumptions used to estimate fair value were as follows:

	Year Ended December 31	
	2011	**2010**
Expected volatility	**48.00%**	48.00%
Interest rate	**0.63-1.69%**	1.40-2.08%
Expected life (years)	**4.00**	4.00
Dividend yields	**0.00%**	0.00%

A summary of Class B unit activity under the LLC's plans is as follows:

	Year Ended December 31	
	2011	**2010**
Outstanding, beginning of year	**14,603,082**	12,082,781
Issued	**10,275,022**	2,666,100
Forfeited	**(1,526,985)**	–
Repurchased	**(1,528,783)**	(145,799)
Outstanding, end of period	**21,822,336**	14,603,082
Vested, end of period	**10,603,035**	7,731,422

19. Unit Compensation Plans (continued)

A status of the LLC's nonvested Class B units as of December 31, 2011, and changes during the years ended December 31, 2011 and 2010, are presented below:

	Class B Units	Weighted-Average Issuance-Date Fair Value
Balance at December 31, 2009	7,626,152	$ 0.26
Issued	2,666,100	0.40
Vested	(3,420,592)	0.27
Forfeited	–	0.00
Balance at December 31, 2010	6,871,660	0.29
Issued	**10,275,022**	**0.47**
Vested	**(4,400,396)**	**0.33**
Forfeited	**(1,526,985)**	**0.31**
Balance at December 31, 2011	**11,219,301**	**$ 0.43**

The unit-based compensation expense recognized for the years ended December 31, 2011 and 2010 was $1.7 million and $0.9 million, respectively. Unrecognized compensation expense was $4.3 million and $1.9 million as of December 31, 2011 and 2010, respectively. Unit-based compensation expense is recognized on a straight-line basis over the vesting period of the units.

20. Related-Party Transactions

The Company declared and paid dividends to the LLC of $5.7 million and $0.0 million in the years ended December 31, 2011 and 2010, respectively.

In connection with the Acquisition discussed in Note 3, the Company paid $2.6 million to a shareholder of the LLC for advisory services. Approximately $2.0 million of this amount is included in merger expenses in the accompanying consolidated statement of operations and approximately $0.6 million is included as deferred financing costs on the accompanying consolidated balance sheet.

21. Leases

The Company leases office space, copiers and fax machines, and medical equipment under non-cancelable operating leases with terms ranging from one to ten years. Rental expense was approximately $7.0 million and $5.5 million for the years ended December 31, 2011 and 2010, respectively.

The Company's future minimum rental commitments under all non-cancelable operating leases as of December 31, 2011, are as follows (in thousands):

2012	$	4,673
2013		3,599
2014		2,937
2015		2,122
2016		651
Thereafter		335
Total minimum rental obligations	$	14,317

22. Employee Profit-Sharing Plans

The Company provides an employee savings plan that permits employees to make contributions in accordance with Internal Revenue Code Section 401(k). Employees who meet age and service requirements are eligible to participate by contributing up to 50% of their pretax compensation up to the IRA limits on the 401(k) plan, along with provisions for catch-up contributions allowable for employees age 50 years and above. The Company provides a discretionary match based upon the employee's status and operating results. For those individuals who are considered highly compensated, the Company provides a non-qualified deferred compensation plan in which certain of the Company's employees participate. Employees are allowed to contribute up to 50% of their compensation, with the Company providing a discretionary match each year based on operating results.

Total expense recognized by the Company under these plans was $1.3 million and $1.1 million for the years ended December 31, 2011 and 2010, respectively.

22. Employee Profit-Sharing Plans (continued)

Additionally, the Company contributes to two multiemployer pension plans on behalf of employees covered by collective bargaining agreements under the New York City Department of Health and Mental Hygiene contract (NYC Contract). Generally, the plans provide defined benefits to substantially all employees covered by the collective bargaining agreements. The Company is reimbursed under its cost-plus NYC Contract for the actual costs and average increases required under the collective bargaining agreements. In 2011, the contributions to these plans, which were reimbursed to the Company, due to the cost-plus nature of the NYC Contract were $2.3 million. There were no payments made to multiemployer pension plans prior to the Acquisition discussed in Note 3.

Under the Employee Retirement Income Security Act of 1974, as amended ERISA), a contributor to a multiemployer plan may be liable, upon termination or withdrawal from a plan, for a proportionate share of a plan's unfunded vested liability, if any. No liability is presently required to be recorded as the future funded status of the plans, as well as the probability of any withdrawal event, are unknown. The Company would also seek reimbursement of any such liability from the client under the cost-plus NYC Contract.

23. Commitments and Contingencies

The Company is involved in various other legal proceedings incidental to its business, substantially all of which involve claims related to alleged medical malpractice, contractual disputes, or individual employee relations matters and which in some cases include assertions of class action status for which insurance coverage may be limited or entirely unavailable. The Company maintains both general and professional liability insurance at levels consistent with or in excess of industry practice. Management routinely reviews the claims internally and with third-party claims administrators and insurance carriers to determine if any adjustments to reserves or changes in coverage are warranted. Management reviews matters for which insurance is not available to establish reserves as it deems appropriate for known and anticipated uninsured losses.

Financial Statement Schedule (Unaudited)

Valitás Health Services, Inc. and Subsidiaries

Proforma Statements of Operations
(In Thousands)(Unaudited)

	Year Ended December 31 2011	2010
Healthcare revenues	**$ 1,328,164**	$ 1,389,024
Operating costs and expenses:		
Healthcare expenses	**1,174,172**	1,244,328
Selling, general and administrative expenses	**58,058**	52,154
Depreciation and amortization	**51,637**	48,525
Healthcare expenses	**1,283,867**	1,345,007
Operating income	**44,297**	44,017
Interest expense, net	**(33,837)**	(33,310)
Income before income taxes	**10,460**	10,707
Income tax provision	**5,409**	5,138
Net income	**$ 5,051**	$ 5,569

The table above presents the consolidated operations of the Company on an unaudited pro forma basis as if the Company's acquisition of America Service Group Inc. had occurred as of January 1, 2010 and all estimated synergies were implemented and fully effective for the full years of 2010 and 2011. Significant pro forma adjustments include the following:

(a) The results of operations of America Service Group Inc. for the period prior to the acquisition, January 1, 2010 to June 2, 2011, have been included.

(b) One-time expenses associated with the acquisition have been removed.

(c) Amortization expense has been adjusted to reflect the amortization of contract and trade name intangible assets acquired in the acquisition of America Service Group Inc. and the amortization of a previously existing trade name intangible asset associated with Correctional Medical Services, Inc.

(d) Interest expense has been adjusted to reflect the revisions to the Company's outstanding debt which resulted from the acquisition.

The pro forma results of operations shown above assume that $16.8 million of annual synergies, estimated to be achieved after the acquisition, are fully in place for the entire period in 2010 and 2011.

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